



SENATE TAXATION
EXHIBIT NO. 3
DATE 3-8-2013
BILL NO. SB 309

Officers, 2012-2013

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March 7, 2013

The Honorable Bruce Tutvedt, Chairman
Members of the Senate Taxation Committee

RE: COST Opposition to SB 309

Mr. Chairman and Members,

I am writing to express the Council On State Taxation's (COST) opposition to Senate Bill 309. Senate Bill 309 would expand the list of so called "tax havens" (re-labeled 'nonexempt countries' by the proposal) for Montana corporate income tax purposes to include Hong Kong, Ireland, the Netherlands, Singapore, and Switzerland. We wish to reiterate our grave concerns for expanding that list in any respect and would instead encourage the Committee to consider removing it altogether. The branding of specific nations as "tax havens" and thereby penalizing companies who merely do business there is bad tax policy. It has been nearly 10 years since Montana started blacklisting specific countries, and no other state has followed suit. The two other jurisdictions that single out tax havens have stopped short of blacklisting specific countries. In fact, the blacklisting of specific countries has been rejected by the Multistate Tax Commission in their model legislation.

About COST

COST is a nonprofit trade association based in Washington, DC. COST was formed in 1969 as an advisory committee to the Council of State Chambers of Commerce and today has an independent membership of nearly 600 major corporations engaged in interstate and international business. COST's objective is to preserve and promote equitable and nondiscriminatory state and local taxation of multijurisdictional business entities.

Tax Haven Lists are Arbitrary and Misleading

Although multi-national corporate affiliations existed well before the turn of the century, it wasn't until sometime in the late 1960s and early 1970s that certain states began to require foreign affiliates to be combined as part of a "unitary group." This method, known as "worldwide combination", became the subject of much international attention because of its implications for taxing foreign earned income.

The objection to worldwide combination came from many of our nation's strongest trading partners, in particular the British and Japanese. It's not often that the tax policies of a state are the subject of debate in the British Parliament, much less legislation. In 1985, the U.K. approved legislation that would have allowed the U.K. Treasury to penalize multinational groups of companies with operations in any U.S. state which employed the worldwide unitary method.

No nation, not even the U.S., has adopted a unitary apportionment methodology for the purpose of taxing *international* businesses. International tax, and the numerous bilateral double taxation treaties to which the U.S. is a party, is predicated largely on the arm's length / separate accounting methodology where tax is imposed on foreign-owned companies only on the profits arising in the country or state in which they operate. Thus, from a foreign competitor's point of view, when a U.S. company goes abroad, they are not subjected to the type of tax reach that worldwide combination was seen as trying to place on foreign companies coming to the U.S. This duplicity was the foundation for what could have resulted in an international tax war had the states adopting worldwide combination not done something to limit its scope.

The solution was the "water's-edge" election. Under this regime, companies may elect, for a set period of time (*e.g.*, seven years), to apportion to a state either their worldwide income or their water's-edge income—income earned within the "water's-edge" of the United States. The water's-edge was intended to roughly measure what the federal government viewed as within reach for federal income tax purposes. Montana, along with all other combined reporting states, offers a water's-edge election.

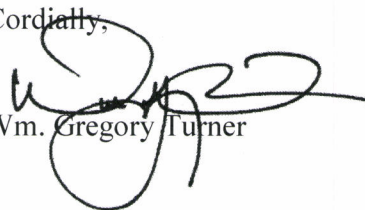
Unfortunately, in 2003 Montana enacted section 15-31-322, MCA which identified a number of countries as "tax havens" and thereby forced any company having business in one or more of them to include their activities there within the water's-edge. The list of countries identified was derived largely from a list created by the OECD (Organization for Economic Cooperation and Development) in 1998, which has since been largely repudiated as a basis for blacklisting specific nations for tax purposes. In fact, only two other jurisdictions—West Virginia and the District of Columbia—have maintained any provisions dealing with "tax haven" countries. Neither of those jurisdictions take the blacklist approach, but instead provide criteria for identifying a tax haven. The Multistate Tax Commission, when considering this matter for their model state legislation, has specifically rejected the blacklist approach in favor of criteria.

Moreover, the mere fact that a company is incorporated in a so-called tax haven country does not by any definition mean that the company is somehow engaged in abusive tax avoidance strategies, which is the alleged rationale for blacklisting such countries. A consumer products company, for example, can hardly be claimed to engage in abusive tax avoidance merely because they choose to incorporate a business unit in a blacklisted country in order to access customers there. It is wrong to assume that companies incorporated in these countries are *de facto* engaged in untoward activities and thus should be subject to punitive taxation by a single U.S. State.

Certainly Montana, like every other state, has an interest in ensuring that companies engaging in multinational business enterprises fairly apply the tax laws and are not engaged in illegal tax avoidance strategies. Montana has at its disposal tools which can address such issues with those who engage in tax avoidance strategies without the arbitrary approach created by section 15-31-322, MCA.

COST respectfully urges the Committee to reject SB 309 and consider removing the list of "tax haven" countries altogether.

Cordially,



Wm. Gregory Turner

cc: COST Board of Directors
Douglas L. Lindholm, President & Executive Director, COST
Nancy Schlepp, President, Montana Taxpayers Association
Webb Brown, President & CEO, Montana Chamber of Commerce